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4 BEFORE THE INSURANCE COMMISSIONER  
5 OF THE STATE OF WASHINGTON  
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7 In the Matter of

No. G02-45

8 THE APPLICATION REGARDING  
9 THE CONVERSION AND  
10 ACQUISITION OF CONTROL OF  
PREMERA BLUE CROSS AND  
ITS AFFILIATES

PRE-FILED RESPONSIVE  
TESTIMONY OF EDWARD A.  
GOLD

11 I, Edward A. Gold, do hereby declare that the following facts are personally  
12 known to me and, if called upon to do so, I would testify to them.

13 1. I reviewed the pre-filed direct testimony and reports presented by  
14 Premera and offer responsive testimony related to the reports, supplemental reports, and  
15 pre-filed testimony of Audrey L. Halvorson and Thomas McCarthy. The arguments  
16 made in the reports and testimony are similar to or depend upon one another.  
17 Consequently, these comments respond to the themes raised in the aggregate in  
18 Premera's presentations.

19 2. Thomas McCarthy puts forward a market share for Premera in the market  
20 for selling health insurance that is misleading with respect to its implications regarding  
21 the possible use of market power by Premera. Dr. McCarthy's market share is based on  
22 a calculation of Premera's share of insured lives among the entire state of Washington  
23 and among all product lines without further stratification. A methodology such as this  
24 implicitly assumes that the market share achievable in the short term for a current or

1 potential competitor in any particular segment will be in proportion to that competitor's  
2 overall market share of the broadly defined market. The methodology fails to account  
3 for characteristics of actual and potential competitors that suggest alternative methods  
4 of measuring achievable market share would be more appropriate. As an example,  
5 Regence is at a disadvantage to Premera in the 14 counties in which it does not hold a  
6 Blue Cross or Blue Shield service mark. Since this disadvantage does not exist in the  
7 Western part of Washington, Regence's market share in Western Washington is not a  
8 good indicator of its market share achievable in the short term in Eastern Washington.

9       3. Dr. McCarthy's market share calculation is a reflection of his market  
10 definition. In his report, Dr. McCarthy states that his market definition is based on a  
11 consideration of both demand and supply substitution. However, supply substitution  
12 describes a response by suppliers to divert resources away from the production of one  
13 set of goods in a particular location and into a new set of goods in a particular location.  
14 Dr. McCarthy's methodology implies that all of a competitor's resources within his  
15 broad market definition are available to be diverted. Regence and other firms proffered  
16 by Premera's management and consultants as current and potential competitors to  
17 Premera in the commercial insurance product lines in Eastern Washington would not  
18 substitute the entirety of their resources away from the other product lines and locations  
19 in which they currently sell. For this reason, it is important to avoid confusing market  
20 shares with market definitions that incorporate supply substitution.

21       4. Given the information and conclusions put forward by other individuals  
22 in this matter, the market shares computed by Professor Leffler are more reasonable.

23       5. It is reasonable to assume that premiums in Eastern Washington in the  
24 individual and regulated small lines of business can rise at least a few percentage points

1 beyond the rate of increase of health care costs for more than a short period of time  
2 given the regulatory environment described by Mr. Staehlin. The greater the price  
3 increase attempted by Premera, the shorter would be the time in which incremental  
4 profits could be generated. Some of the factors that might allow prices to rise beyond  
5 the rate of increase in health care costs include:

6           A.     The fact that developing a network takes time and resources as  
7 stated by Mr. Ancell and Mr. Donigan in their testimony.

8           B.     The cost of renting a network is approximately 1 percent of  
9 premium revenue based on information presented by Professor Leffler. This additional  
10 cost may create a cost disadvantage that Premera does not face. Greater reimbursement  
11 rates from a rental network add to the cost disadvantage.

12           C.     Significant capital may be needed to fund significant increases in  
13 membership and not-for-profit firms may be restricted in their ability to raise those  
14 funds as stated by Mr. Barlow, Mr. Marquardt and Mr. Kinhead in their testimony.

15           D.     Premera's Blue Cross and Blue Shield marks convey value to  
16 consumers as stated by Mr. Barlow and Mr. Kinhead in their testimony. The potential  
17 and current competitors do not have this trademark in most counties in Eastern  
18 Washington.

19           E.     Non-trivial switching costs exist as described by Ms. Hunt and  
20 Professor Leffler.

21           These factors suggest that the individual and regulated small group product lines  
22 in the Eastern Washington counties in which Premera holds a market share greater than  
23 65 percent are the most likely segments susceptible to a rise in prices beyond the rate of  
24 increase in health care costs.

1 I declare under penalty of perjury under the laws of the State of Washington  
2 that the foregoing is true and correct.

3 Dated April 14, 2004 at Washington, DC.  
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6 EDWARD A. GOLD  
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